MANAGEMENT'S DISCUSSION AND ANALYSIS
(unaudited)

As management of Chesterfield County (County), we offer readers of the County's financial statements this narrative overview and analysis of the financial activities of the County for the fiscal year ended June 30, 2004. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal at the front of this report and the County's financial statements, which follow this analysis.

FINANCIAL HIGHLIGHTS

- The County's total net assets increased approximately $68.7 million (6.6%). Net assets of the governmental-type activities increased $39.7 million (9.2%) and net assets of the business-type activities increased $29.0 million (4.8%).
- The County's unrestricted net assets increased approximately $32.8 million (15.7%). Unrestricted net assets of the governmental-type activities increased $11.1 million (14.6%) and unrestricted net assets of the business-type activities increased $21.7 million (16.4%)
- The County's program and general revenues (including taxes) of $622.4 million for governmental-type activities (excluding transfers and extraordinary loss) exceeded expenses of $582.1 million by $40.3 million.
- In the County's business-type activities, revenues increased 1.2% to $77.7 million while expenses increased by 1.3% to $46.9 million (excluding transfers and extraordinary loss).
- The total cost of the County's primary government's programs increased approximately $53.3 million (9.3%) to $629.0 million.
- The General Fund reported an ending fund balance amount of $114.8 million, an increase of $10.9 million (10.5%) in comparison with the prior year. Of the ending fund balance amount, $49.4 million was unreserved and undesignated.
- The County's outstanding debt increased by $43.4 million (10.7%). General obligation refunding bonds were issued in the amount of $60.1 million, Virginia Public School Authority (VPSA) bonds were issued in the amount of $56.8 million and certificates of participation were issued in the amount of $22.0 million. The effect of issuing new debt exceeded the effect of the principal payments on and the defeasement of existing debt.
- On September 18, 2003, the County was impacted by a natural disaster and in the following weeks provided an emergency response and took measures to protect the lives and property of its residents. Heavy rain and wind from Hurricane Isabel damaged and downed trees and interrupted electrical power. The County opened an Emergency Operations Center (EOC) and a shelter and provided emergency ice, water and food in response to its citizens' needs. By far, the largest initiative the County took in the months following Hurricane Isabel was in the area of debris removal. Uprooted trees and vegetative debris were scattered on trails, public properties and rights-of-way and posed a threat to the health and safety of the County's residents. The County responded by removing this debris and by providing for curbside removal of debris from residents' private property. Costs incurred related to Hurricane Isabel are partially reimbursable by emergency relief funds from both the United States Department of Homeland Security's Federal Emergency Management Agency (FEMA) and the Commonwealth and include personnel, contract and materials expenditures and damages to property. Due to the unusual nature of this event that was outside of management's control, the net cost of this disaster was reported as an extraordinary loss in the County's financial statements. Before reimbursement, the governmental activities of the County incurred approximately $11.8 million in expenses related to the hurricane and the business activities incurred approximately $0.7 million in expenses. More detailed financial information regarding this event is disclosed on page 80 of the footnotes.

OVERVIEW OF THE FINANCIAL STATEMENTS

The County's Comprehensive Annual Financial Report (CAFR) consists of four sections: introductory, financial, statistical, and compliance. The financial section consists of five components – the independent auditors' report, management's discussion and analysis (this component), the financial statements, required supplementary information, and supplementary information. The financial statements include two categories of statements that present different views of the County:

- The first two statements are government-wide financial statements that provide a broad overview of both long-term and short-term information of the County's financial status.
- The remaining statements are fund financial statements that focus on individual parts of the County government and report the County's operations in more detail than the government-wide statements:

- Governmental fund statements tell how general government services, such as public safety, are financed in the short-term as well as what resources remain for future spending.
- Proprietary fund statements offer both short-term and long-term financial information about activities the government operates like private-sector businesses, such as the water and wastewater systems.
- Fiduciary fund statements provide information about the financial relationships, such as the supplemental retirement plan for certain qualified County employees, in which the County acts solely as a trustee or agent for resources belonging to others.

The notes, a component of the financial statements, provide additional details for understanding the information presented in the CAFR. The notes are followed by a section of required supplementary information that further explains and supports the pension plan information reported in the financial statements. The CAFR also includes a supplementary section containing combining schedules for the non-major governmental funds, the agency funds and the internal service funds, additional schedules and School Board component unit fund schedules.

Government-wide Statements

The government-wide statements report information about the County as a whole using accounting methods similar to those used by private-sector businesses. The statement of net assets includes all of the government's assets and liabilities, both short-term and long-term. The statement of activities reports all of the current year's revenues and expenses as soon as the underlying event for recognition occurs, regardless of the timing of the related cash flows. The government-wide statements report the County's net assets and how they have changed. Net assets, the difference between the County's assets and liabilities, is a measure of the County's financial health, or position:

- Over time, increases or decreases in the County's net assets are an indicator of whether its financial health is improving or deteriorating, respectively.
- To assess the overall health of the County, CAFR users should consider additional nonfinancial factors such as changes in the County's property tax base.

The government-wide financial statements of the County are divided into three categories:

- Governmental activities – Most of the County's basic services, such as police, fire, social services, parks and recreation, and general administration, are included in governmental activities. Property taxes and state and federal funding finance the majority of these activities' expenses.
- Business-type activities – Activities that are intended to recover all or a significant portion of their costs through user fee charges to external parties for goods or services are included in the business-type activities.
- Component units – The County includes two other entities in its report: the School Board and the Health Center Commission. Although legally separate, these component units are presented because of the County's financial accountability for them.

Fund Financial Statements

The fund financial statements provide more detailed information about the County's major funds and not the County as a whole. Funds are accounting devices that the County uses to track resources that are segregated for specific activities or objectives. Some funds are required by state law or by bond covenants. Other funds are established to control and manage money for particular purposes or to show that the County is using certain taxes and grants for their intended purposes.

The County has three kinds of funds:

- Governmental funds – Most of the County's basic services are included in governmental funds which focus on (1) how cash and other financial assets that are readily convertible to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the statements for governmental funds provide a detailed short-term view that assists the CAFR reader in determining the status of financial resources available for financing the County's programs in the near future. Because this information does not encompass the additional long-term focus of the government-wide statements, the County provides additional information, either at the bottom of the governmental funds statement or on the following page, that explains the differences between the short-term and long-term focus.
- Proprietary funds – Services that are intended to recover all or a significant portion of their costs through user fees are reported in proprietary funds. Proprietary fund financial statements, like the government-wide statements, provide both long and short-term financial information and they also provide additional details and information, such as the statement

of cash flows. The County's enterprise funds are reported in the business-type activities of the government-wide statements because these funds generally provide services to customers external to the County. The internal service funds are reported in the governmental-type activities of the government-wide statements because those funds provide supplies and services internally to the County's other programs and activities.

- Fiduciary funds – The County is responsible, as trustee, for the assets of various trust and agency funds that can be used only for the fiduciary beneficiaries. The County is responsible for ensuring that the assets reported in these funds are used for their intended purposes. All of the County's fiduciary activities are reported in a separate statement of fiduciary net assets and a statement of changes in fiduciary net assets. These activities are excluded from the County's government-wide financial statements because the County cannot use fiduciary assets to finance its operations.

FINANCIAL ANALYSIS OF THE COUNTY AS A WHOLE

Net assets. The County's assets exceeded liabilities by $1.1 billion at the close of the most recent fiscal year. This represents a 6.6% increase over the prior year.

TABLE 1
Chesterfield County's Net Assets
June 30, 2003 and 2004
(in millions of dollars)

	Governmental Activities		Business-type Activities		Total Primary Government		School Board Component Unit	
	2003	**2004**	**2003**	**2004**	**2003**	**2004**	**2003**	**2004**
Assets								
Current and other assets	$ 314.8	$ 398.8	$ 196.2	$ 203.8	$ 511.0	$ 602.6	$ 52.7	$ 55.3
Capital assets	672.2	690.2	468.7	486.7	1,140.9	1,176.9	12.9	10.6
Total assets	**987.0**	**1,089.0**	**664.9**	**690.5**	**1,651.9**	**1,779.5**	**65.6**	**65.9**
Liabilities								
Long-term liabilities	403.7	450.8	31.4	27.9	435.1	478.7	16.1	18.2
Other liabilities	153.8	169.0	28.7	28.8	182.5	197.8	40.7	43.1
Total liabilities	**557.5**	**619.8**	**60.1**	**56.7**	**617.6**	**676.5**	**56.8**	**61.3**
Net assets								
Invested in capital assets, net of related debt	341.1	360.3	439.3	461.5	780.4	821.8	12.9	10.6
Restricted	12.5	21.9	33.0	18.1	45.5	40.0	3.9	4.4
Unrestricted (deficit)	75.9	87.0	132.5	154.2	208.4	241.2	(8.0)	(10.4)
Total net assets	**$ 429.5**	**$ 469.2**	**$ 604.8**	**$ 633.8**	**$ 1,034.3**	**$ 1,103.0**	**$ 8.8**	**$ 4.6**

At the end of both the current and prior fiscal years, the County reported positive balances in all three categories of net assets, both for the primary government as a whole, as well as for its separate governmental and business-type activities. The largest portion (74.5%) of the County's net assets at June 30, 2004, is its investment in capital assets (e.g. land, buildings, machinery, equipment and infrastructure), less accumulated depreciation and any debt used to acquire those assets that remains outstanding at year-end. The County uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the County's investment in its capital assets is reported net of related debt, it should be noted that the resources required to repay the debt must be provided from other sources because capital assets are not generally liquidated for the purpose of retiring debt. An additional portion of the County's net assets (3.6%) represents resources that are subject to external restrictions on how they may be used. The remaining balance is referred to as unrestricted net assets (21.9%). Unrestricted net assets are available to meet the County's ongoing obligations to citizens and creditors.

School Board component unit assets exceeded liabilities by $4.6 million at the end of the current fiscal year. This represents a decrease of $4.2 million (47.7%) compared to the prior year (See Table 1). Net assets, invested in capital assets, net of related debt, decreased by $2.3 million because depreciation expense exceeded capital outlay. The School Board reported a deficit unrestricted net assets of $10.4 million due primarily to funding liabilities related to judgments, claims, and compensated absences of $17.4 million, which increased by $2.2 million compared to the prior year on a pay as you go basis.

Changes in net assets. The County's total revenues (excluding extraordinary losses and transfers) increased over the prior year by 7.3% to $700.1 million. (See Table 2). The total cost of all programs increased by 9.3% to $629.0 million. (See Table 2).

TABLE 2
Changes in Chesterfield County's Net Assets
For the Years Ended June 30, 2003 and 2004
(in millions of dollars)

	Governmental Activities		Business-type Activities		Total Primary Government		School Board Component Unit	
	2003	**2004**	**2003**	**2004**	**2003**	**2004**	**2003**	**2004**
Revenues:								
Program revenues:								
Charges for services	$ 44.5	$ 48.8	$ 45.8	$ 45.9	$ 90.3	$ 94.7	$ 13.1	$ 14.0
Operating grants and contributions	73.4	79.6	-	-	73.4	79.6	51.6	54.4
Capital grants and contributions	8.1	13.2	28.3	30.0	36.4	43.2	-	0.1
General revenues:								
Property taxes	237.1	252.7	-	-	237.1	252.7	-	-
Other taxes	79.7	86.0	-	-	79.7	86.0	-	-
Payment from School Board	83.4	93.4	-	-	83.4	93.4	-	-
Payment from County	-	-	-	-	-	-	248.7	280.4
Grants and contributions not restricted to specific programs	46.9	46.4	-	-	46.9	46.4	114.8	121.2
Other	2.3	2.3	2.7	1.8	5.0	4.1	0.5	0.8
Total revenues	**575.4**	**622.4**	**76.8**	**77.7**	**652.2**	**700.1**	**428.7**	**470.9**
Expenses:								
General government	38.0	38.2	-	-	38.0	38.2	-	-
Administration of justice	8.0	8.4	-	-	8.0	8.4	-	-
Public safety	103.2	111.3	-	-	103.2	111.3	-	-
Public works	20.9	20.2	-	-	20.9	20.2	-	-
Health and welfare	47.2	52.0	-	-	47.2	52.0	-	-
Parks, recreation and cultural	18.4	20.4	-	-	18.4	20.4	-	-
Education - School Board	264.3	301.5	-	-	264.3	301.5	447.7	474.7
Non-departmental	-	-	-	-	-	-	-	-
Interest on long-term debt	16.9	17.2	-	-	16.9	17.2	-	-
Airport	-	-	1.2	1.2	1.2	1.2	-	-
Water	-	-	22.1	22.0	22.1	22.0	-	-
Wastewater	-	-	23.0	23.7	23.0	23.7	-	-
Total expenses	**529.4**	**582.1**	**46.3**	**46.9**	**575.7**	**629.0**	**447.7**	**474.7**
Increase (decrease) in net assets before transfers and extraordinary loss	**46.0**	**40.3**	**30.5**	**30.8**	**76.5**	**71.1**	**(19.0)**	**(3.8)**
Extraordinary loss	-	(1.8)	-	(0.6)	-	(2.4)	-	(0.4)
Transfers	0.7	1.2	(0.7)	(1.2)	-	-	-	-
Increase (decrease) in net assets	**46.7**	**39.7**	**29.8**	**29.0**	**76.5**	**68.7**	**(19.0)**	**(4.2)**
Net assets - July 1	**382.8**	**429.5**	**575.0**	**604.8**	**957.8**	**1,034.3**	**27.8**	**8.8**
Net assets - June 30	**$ 429.5**	**$ 469.2**	**$ 604.8**	**$ 633.8**	**$ 1,034.3**	**$ 1,103.0**	**$ 8.8**	**$ 4.6**

Approximately 36% of the County's revenues came from property taxes and approximately 12% comes from other taxes. Another 24% of the total revenue came from grants and contributions. The remaining revenues are charges for services, payment from School Board, investment earnings and miscellaneous (See Figure A-1). The County's expenses cover a range of services with 75% related to public safety, health and welfare and education (See Figure A-2). Program revenues of the County's governmental activities covered 24% of its expenses.

Figure A-1
Chesterfield County
Sources of Revenue for Fiscal Year 2004

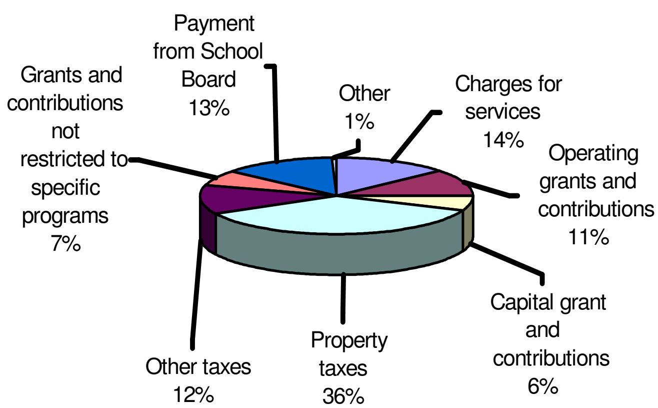
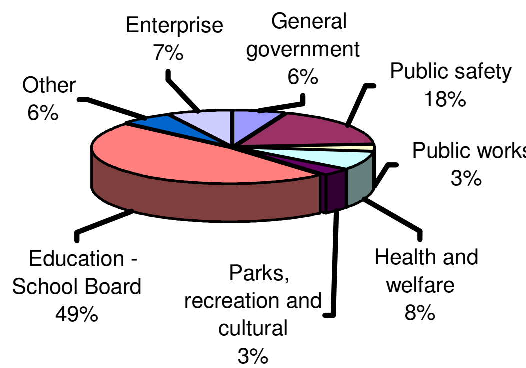


Figure A-2
Chesterfield County
Functional Expenses for Fiscal Year 2004



The School Board's total revenues (excluding extraordinary losses) increased compared to the prior year by 9.8% to $470.9 million. The total expenses of all school programs and services increased over the prior year by 6.0% to $474.7 million. Program revenues of School Board activities covered 14.4% of its expenses.

Governmental Activities

Governmental activities increased the County's net assets by $39.7 million and accounted for 57.8% of the total growth in the net assets of the County. Revenues for governmental activities increased $47.0 million (8.2%) and total expenses increased $52.7 million (10.0%) when compared to the prior year. Key elements of these changes are as follows:

- Overall, property tax revenues increased by $15.6 million (6.6%) during the year. This increase is due to an 8.3% increase in the assessed valuation of taxable real and personal property over the preceding year. Real property's assessed valuation increased 10.1% over the last fiscal year. Of the real property increase, 34.5% is due to new residential construction, 5.9% is due to new commercial/industrial construction, and 59.6% is due to revaluation and changes of existing properties. Commercial and industrial property comprised 21.0% of the total real property taxable value. The real estate tax rate was $1.07 per $100 of assessed value and was effective for both the current and prior fiscal years. Growth of 4.2% in personal property values resulted from an increase in new and used car registrations in the County. The Personal Property Tax Relief Act of 1998 (PPTRA) provides for the Commonwealth to reimburse localities a portion of the personal property tax levied on the first $20,000 of personal use cars, motorcycles, and trucks. For tax years 2004 and 2003, the reimbursement rate was 70%. The Commonwealth requires localities to record the revenue from PPTRA as received from other governments, not as property taxes. When the Commonwealth reimbursement is added back to property taxes, there is an increase of $15.0 million (5.5%) over the prior fiscal year.
- The payment from School Board increased by $10.0 million (12.0%) over the prior year. Payments related to refunding bonds issued by the County on behalf of the School Board increased by $26.4 million. There was an increase of $1.8 million related to the current fiscal year's debt service payments made on behalf of the School Board. Increases were offset by a decrease of $17.4 million payment of net assets that was made in the prior fiscal year from the School

Board's Capital Projects Fund to the School Capital Projects Fund of the primary government. The remaining difference of $0.8 million is attributable to a decrease in miscellaneous transactions that occur between the County and the School Board related primarily to capital assets.

- Overall, expenses increased by $52.7 million (10.0%). Functional categories experienced increases or decreases compared to the prior year. The Education – School Board function increased by $37.2 million (14.1%) due to an increase of $27.2 million in refunding and VPSA bonds issued on the School Board's behalf in the current fiscal year and an increase of $6.4 million provided to the School Board for operating and maintenance costs. Public safety programs experienced increased expenses of $8.1 million (7.8%) mainly due to staffing a new facility and equipment purchases in the fire department and an increase in personnel costs in the police department. Health and welfare programs experienced an increase of $4.8 million (10.2%) in expenses during the year mainly due to increases in mental health/mental retardation and substance abuse programs funded by Medicaid and to an overall increase in the number of customers served by social services' programs.

Business-type Activities

Business-type activities increased the County's net assets by $29.0 million, accounting for 42.2% of the total growth in the net assets of the County. Revenues for business-type activities increased $0.9 million (1.2%) and total expenses increased by $0.6 million (1.3%) when compared to the prior year. Key elements contributing to these results are as follows:

- Charges for services for the water and wastewater operations increased slightly over the prior year.
- Capital grants and contributions for business-type activities increased overall by $1.7 million (6.0%). Water connection fees increased $2.3 million and developer contributions of water pipelines increased $1.0 million in the current year compared to the prior year due to increased connection activity and an increase in connection fees. Wastewater connection fees increased $0.7 million in the current year. In the prior fiscal year, Wastewater had pipeline contributions from a special assessment district that totaled $1.5 million. There was no special assessment in Wastewater in the current fiscal year. Capital contributions for Airport facilities decreased by $1.0 million over the prior year because there was a decrease in the construction costs associated with state and federally funded grant awards.
- Investment earnings and unrealized gains on investments of business-type activities decreased by $0.9 million (33.3%) due to lower interest rates.

School Board Activities

School Board activities decreased its net assets by $4.2 million (47.7%). Key elements of these changes are as follows:

- Total revenues increased overall primarily due to the payment from Chesterfield County increasing by $31.7 million (12.7%). This year, the County provided $52.1 million, an increase of $27.1 million, to the School Board for the refunding of existing general obligation debt that was issued on behalf of the School Board and $1.0 million in equipment purchased by the County's School Capital Projects Fund. Grants and contributions not restricted to specific programs increased $6.4 million (5.6%) due to receiving additional State Standards of Quality funding which resulted from an increase in student average daily membership.
- Expenses increased by $27.0 million (6.0%) mainly due to increases of $11.8 million in instructional expenses and $1.8 in operations and maintenance expenses offset by a decrease of $1.8 million in pupil transportation expenses. Debt service expenses increased by $28.2 million due to the increase in refunding of existing debt. These increases were offset by the payment from the School Board Capital Projects Fund of $17.4 million in net assets to the County's School Capital Projects Fund in the prior year. Expenses related to long-term liabilities increased by $2.1 million.

FINANCIAL ANALYSIS OF THE COUNTY'S FUNDS

Governmental Funds

The focus of the County's governmental funds is to provide information on near-term inflows and outflows and the balance of resources available for spending. Such information is useful in assessing the County's financing requirements. In particular, unreserved, undesignated fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

As the County completed the year, its governmental funds reported a combined fund balance of $212.7 million, an increase of $66.2 million compared to the previous year. $58.3 million (27.4%) of this amount constitutes unreserved fund balance, of which $49.3 million is available for governmental spending and $9.0 million is designated by management for tentative spending plans. The remainder of fund balance is reserved to indicate that it is not available for new spending.

The General Fund is the operating fund of the County. At the end of the current fiscal year, unreserved fund balance of the General Fund was $58.5 million and total fund balance was $114.8 million. As a measure of the General Fund's liquidity, it may be useful to compare both unreserved fund balance and total fund balance to total fund expenditures. Unreserved fund balance represents 10.5% of total General Fund expenditures. Of unreserved fund balance, the undesignated amount of $49.4 million represents 8.9% of total General Fund expenditures and exceeds the Board of Supervisors' target of 7.5%. Total fund balance represents 20.6% of General Fund expenditures.

Fund balance of the General Fund increased by $10.9 million during the current fiscal year. Key factors in this change are as follows:

- Real estate tax revenues increased by $16.1 million (8.9%) due to the increase of 10.1% in the assessed valuation of taxable real property. The real estate tax rate was $1.07 per $100 of assessed value and was effective for both the current and prior fiscal years. Other general property tax revenues increased $0.6 million, mainly due to an increase of $1.5 million in personal property taxes resulting from an increase of 4.2% in personal property tax assessments and a decrease of $0.9 million in the real and personal public service corporation taxes resulting from 7.1% decrease in public service property assessments. Including the PPTRA reimbursement from the Commonwealth, current tax collections were 96.87% of the total tax levy, a decrease from the prior fiscal year's current tax collections of 96.98%. Total tax collections as a percent of total tax levy decreased from 99.91% in the prior fiscal year to 99.20% in the current fiscal year.
- Investment earnings and unrealized gain on investments decreased by $0.5 million (28.5%) due to declining interest rates in the current year. The average yield on investments for the County in the current fiscal year was 1.24% which exceeded the three month U. S. Treasury Bill average of 0.97% and the Donoghues's Money Fund average of 0.66% by 27 and 58 basis points, respectively. The average yield on investments in the prior fiscal year was 1.69%. Decreases in fair value during the current year, however, do not necessarily represent trends that will continue; nor is it always possible to realize such amounts, especially in the case of temporary changes in the fair value of investments that the County intends to hold until maturity.
- Charges for services increased $1.3 million (5.9%) due an increase of $1.1 million in mental health/mental retardation and substance abuse revenues that resulted from increased State Medicaid funding.
- Revenue from other governments increased $3.6 million (3.4%) mainly due to education – state sales tax categorical aid increasing $2.2 million over the prior year, which is impacted by both the level of retail sales statewide and the proportion of the State's school children residing in the County.
- Public safety expenditures increased by $7.1 million (7.3%). Fire department expenditures were up $2.1 million (7.0%) over last year mainly due to the addition of 18 new full-time positions required to staff the new River's Bend Fire Station as well as providing funding necessary for operation of that facility and additional operational funding for the Winterpock Fire Station that was opened in the prior year. Police department expenditures increased by $2.9 million (8.3%) mainly due to increases in fuel prices, equipment purchases and increased salary expenses.
- Community development expenditures increased by $1.1 million (10.6%) due to purchases of property in the Meadowville Technology Park and the addition of an construction inspector position.

At year-end, the County's Capital Projects Fund had a total fund balance of $29.7 million, of which $20.2 million was reserved for encumbered contracts underway and $9.3 million was reserved to pay future costs associated with County capital projects. The School Capital Projects Fund had a total fund balance of $67.4 million, of which $9.3 million was reserved for encumbered contracts underway and $58.1 million was reserved to pay future costs associated with School capital projects.

General Fund Budgetary Highlights

The overall difference between the original budget and the amended budget for revenues and other financing sources reflected an increase of $34.8 million (7.3%). Budget adjustments were made to various revenue sources and some of the major changes are summarized as follows:

- The budget for other local taxes increased by $0.8 million for greater than anticipated receipts of mobile telephone taxes.
- The budget for miscellaneous revenue increased by $1.6 million primarily due to anticipated third party insurance recoveries for damages incurred from Hurricane Isabel.
- The budget for recovered costs increased by $1.1 million mainly due to receiving $1.2 million from the Riverside Regional Jail Authority (RRJA) as a refund for per diem payments made by the County as a participating locality.

RRJA generated these excess funds by selling beds to federal agencies, contracting with the Commonwealth to hold inmates under the Jail Contract Bed program, and selling beds to non-member jurisdictions.

- The budget for other governments increased by $13.9 million primarily due to appropriating emergency relief funds from both FEMA and the Commonwealth related to Hurricane Isabel.
- The original budget for other financing sources increased by $14.9 million reflecting the decision during the year to sell bonds to refund existing debt.

The final amended budget for expenditures and other financing uses was greater than the original budget by $73.2 million (14.9%). The increase in expenditure appropriations can be summarized as follows:

- The budget for transfers out increased by $34.7 million. The budget for the transfers to the County Capital Projects Fund and the School Capital Projects Fund increased by $21.8 million and $12.5 million, respectively, mainly due to the appropriation of prior year construction reserves.
- The budget for public works was increased by $15.9 million primarily due to the appropriation required for the debris removal effort initiated after Hurricane Isabel.
- The budget for health and welfare increased for mental health/mental retardation and substance abuse and for social services by $1.1 million and $1.0 million, respectively. The increase in mental health/mental retardation and substance abuse is primarily related to the programs funded by Medicaid. The social service increase was primarily related to an overall increase in the number of customers served by social services' programs.
- The budget for public safety increased by $6.1 million primarily due to increases in the fire, police and sheriff and jail operations. A $1.0 million increase in the fire department budget was a result of appropriating additional revenue recovery program funds, insurance recoveries and donations to cover costs related to minimum staffing and the purchase of emergency equipment. The $1.7 million increase in the police department budget included using asset forfeiture revenue to fund the purchase of equipment and training and the appropriation of insurance recoveries for costs incurred related to Hurricane Isabel. The $1.8 million of the increase in the jail operations budget covered additional expenditures incurred due to higher than expected increases in the average jail population of inmates held at the regional jail. The average jail population increased from 504.7 in the prior year to 557.4 through January of the current fiscal year. In addition, the budget for the Sheriff and local jail required an additional appropriation of $0.9 million to fund daily operations.
- The original budget for other financing uses increased by $14.6 million reflecting the decision during the year to sell bonds to refund existing debt.

Actual revenues and other financing sources exceeded the amended budget by $7.4 million. Increased assessed values of real property resulted in a positive variance of $6.5 million in real estate taxes. Lower than expected personal property taxes and PPTRA reimbursements from the Commonwealth resulted in a $3.8 million difference of actual to amended budget. Other local taxes collected exceeded the amended budget by $6.7 million: $1.8 million in recordation taxes due to low interest rates and a strong real estate market; $2.6 million in local sales and use taxes because retail sales in the region increased greater than expected; and $0.6 million in consumer utility taxes for greater than expected collections of mobile telephone taxes. Use of money and property revenue was lower than the amended budget ($2.5 million) because of continued declining interest rates. The amended budget for categorical aid from other governments and miscellaneous revenues exceeded actual revenues by $2.1 million and $1.6 million, respectively, because lower than expected actual expenditures related to the Hurricane Isabel debris removal effort directly affected the receipt of emergency relief funds and insurance recoveries related to Hurricane Isabel.

Actual expenditures and other financing uses were $52.5 million less than the amended budget amount and no legal level of budgetary control was exceeded. Of this amount, $41.2 million is because less than budgeted amounts were transferred out to other funds. The transfer to the School Board accounted for $15.3 million less than the budgeted amount due to lower than expected categorical aid from the Commonwealth that passes through the County and with less spending on capital and maintenance projects throughout the fiscal year. The transfer to the County Capital Projects Fund had $25.7 million less than the budgeted amount due to not transferring all construction reserves. Expenditures in public works were $5.0 million less than expected for the debris removal effort related to Hurricane Isabel.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Overview

Governmental Accounting Standards Board Statement 34 requires the issuing entity to report "on behalf" debt and debt service. The operational relationship between the County and School Board component unit related to capital assets and debt involves several transactions between the two entities that are presented in the statements to meet reporting requirements. Brief descriptions of those transactions are:

- ♦ The School Board can neither levy taxes nor incur debt under Virginia law. The County issues debt "on behalf" of the School Board, which is recorded as a liability of the County's governmental activities. In both the prior and current years, proceeds from debt issued to refund existing debt issued "on behalf" of the School Board were recorded in the County's General Fund and an amount equal to the proceeds received from refunding was then provided to School Board operations for the purpose of funding the retirement of existing debt.
- ♦ The County's charter states that title to all real property of the school system shall be vested in the County of Chesterfield. The County provides the School Capital Projects Fund with funding to purchase and/or construct real property (land, buildings, improvements other than buildings, and construction in progress) for use in school operations. Due to the charter, the value associated with the purchase and/or construction of School Board real property is reported as capital assets in the governmental activities of the County. Depreciation and accumulated depreciation related to School Board real property is reported in the County's governmental activities within the appropriate government-wide statements.
- ♦ The County's budgeting process provides for the School Board component unit to receive funding from the County. The School Board is responsible for allocating funding to cover debt service related to "on behalf" debt and is presented as debt service on the School Board's statement of revenues, expenditures, and changes in fund balance – budget and actual. However, for the statement of revenues, expenditures, and changes in fund balance, the School Board presents a payment to the primary government in an amount to cover debt service payments and payments to escrow agents.

Capital Assets

At the end of the fiscal year, the County had invested $1.2 billion in a broad range of capital assets, including public safety buildings, park facilities, libraries, and water and wastewater lines. (See Table 3). This amount represents a net increase of $36.0 million (3.2%) over the prior year.

TABLE 3
Chesterfield County's Capital Assets
June 30, 2003 and 2004
(net of depreciation, in millions of dollars)

	Governmental Activities		Business-type Activities		Total		Total Percentage Change
	2003	2004	2003	2004	2003	2004	2003-2004
Non-depreciable assets:							
Land	$ 33.6	$ 34.3	$ 3.2	$ 3.2	$ 36.8	$ 37.5	1.9%
Construction in progress	29.0	39.1	6.3	18.6	35.3	57.7	63.5%
Depreciable assets:							
Buildings	519.8	522.3	97.4	96.6	617.2	618.9	0.3%
Improvements other than buildings	21.7	22.7	19.6	18.6	41.3	41.3	0.0%
Machinery and equipment	46.5	48.7	342.2	349.7	388.7	398.4	2.5%
Infrastructure	21.6	23.1	-	-	21.6	23.1	6.9%
Total	**$ 672.2**	**$ 690.2**	**$ 468.7**	**$ 486.7**	**$ 1,140.9**	**$ 1,176.9**	**3.2%**

This year's major capital asset additions and increases in construction in progress included:

- ♦ Completion of the building security upgrades - $0.6 million
- ♦ Completion of various library and park improvements - $4.3 million
- ♦ Completion of School projects: Chalkley Elementary renovations - $5.5 million; Hening Elementary renovations - $2.2 million; Bailey Middle renovations - $4.9 million
- ♦ Completion of water project – Huguenot Springs elevated water tank – $2.4 million

The amount of capital assets (net of accumulated depreciation) used by the School Board in its operations was $405.5 million of the total value of capital assets of the governmental activities.

The County's fiscal year 2005 capital budget projects spending $85.0 million for capital projects, which includes $62.8 million for the primary government and $22.2 million for the School Board. Principal projects for the primary government include a runway and taxiway connector apron at the Airport, a Community Development building, upgrades to the Northern Area Transfer Station, expansion of the Meadowdale Library, a police property/evidence storage facility, the Public Safety Training Center at Enon and various water and wastewater expansion and replacement projects. School projects are principally for school building additions and improvements. The County plans to issue additional debt to finance these and future projects as identified in the Capital Improvement Program 2005-2011. More detailed information about the County's capital assets is presented in Note 8 to the financial statements.

Long-term Debt

At year-end the County had $449.8 million in bonds and leases outstanding, an increase of 10.7% compared to last year (See Table 4). More detailed information about the County's long-term liabilities is presented in Note 9 to the financial statements.

The County issued new debt during the year totaling $56.8 million in general obligation bonds (VPSA for School Board projects.) To take advantage of lower interest rates, the County issued $60.1 million of general obligation refunding bonds to advance refund $1.3 million of outstanding 1997 bonds, $21.3 million of 1998A bonds, $19.0 million of outstanding 2000 bonds, and $18.1 million of outstanding 2001 bonds. By refinancing the debt, the County reduced its debt service payments by $2.6 million over the next sixteen years and obtained an economic gain of $2.1 million. The County also issued $22.0 million in certificates of participation for a new Community Development building, the Chester House Rehabilitative Facility, the Airport hangar project (comprised of a new corporate hangar and a new T-hangar) at the County Airport, an Emergency System Integrations project and for the final funding of the jail renovation.

TABLE 4
Chesterfield County's Outstanding Debt
June 30, 2003 and 2004
(in millions of dollars)

	Governmental Activities		Business-type Activities		Total		Total Percentage Change
	2003	**2004**	**2003**	**2004**	**2003**	**2004**	**2003-2004**
General obligation bonds, net (backed by the County)	$ 336.2	$ 365.2	$ -	$ -	$ 336.2	$ 365.2	8.6%
Revenue bonds, net (backed by fee revenues)	-	-	32.1	27.8	32.1	27.8	(13.4%)
State literary fund loans	4.9	3.4	-	-	4.9	3.4	(30.6%)
Certificates of participation and capital leases	32.8	52.0	0.4	1.4	33.2	53.4	60.8%
Total	**$ 373.9**	**$ 420.6**	**$ 32.5**	**$ 29.2**	**$ 406.4**	**$ 449.8**	**10.7%**

The amount of "on behalf" debt outstanding related to School Board activities is $301.1 million of the total outstanding debt of the governmental activities.

A key debt policy established by the County's Board of Supervisors is the ratio of debt service costs to general government expenditures, which was 7.6% for the current year comparing favorably to the policy target of 10%.

The County's financial standing and management practices have resulted in the award of an Aaa bond rating from Moody's Investors Service, an AAA bond rating from Fitch Investors Service Inc., and an AAA from Standard & Poor's Corporation for general obligation bonds and water and sewer revenue refunding bonds.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The County's unemployment rate rose from 3.0% in 2002 to 3.2% in 2003, and was 3.0% in July 2004. Chesterfield's 2003 unemployment rate of 3.2% was still below the Commonwealth's 4.1% unemployment rate for the same period. At the Commonwealth and regional levels, the latest economic data indicates that the economy remains fairly solid and the near-term outlook is positive. Retail sales continued to improve in the region during calendar year 2003, increasing 8.8% as of December 2003, when compared to 2002. Local sales tax collections were strong in the current fiscal year. Going forward, relatively low interest rates and stronger employment are expected to continue to support new construction and existing home sales in the region's real estate market.

The County developed a Biennial Financial Plan for fiscal years 2005 and 2006 that was adopted on April 14, 2004 while the Commonwealth continued an unprecedented budgetary stalemate. As the budget was adopted, the County awaited closure on the debate over a new tax plan and biennial budget in the General Assembly. After the Commonwealth reached a consensus in early May, staff began to evaluate the full impact to the County of the decisions made by the General Assembly. The County was fortunate to have received significant additional funds, primarily for education. Difficult choices were made as the County developed the budget. Reductions approximating 1.5% (excluding merit increases) adopted with the fiscal year 2003 budget continued into fiscal year 2004 and were not restored with the fiscal year 2005 budget. Departments have been required to rethink the manner in which services are delivered while minimizing any impact on the citizens that they serve. The County has been successful in doing so; however, sustaining such practices becomes more and more difficult. The fiscal year 2005 adopted General Fund budget equals $561.8 million and represents a 6.9% increase over the fiscal year 2004 adopted budget of $525.5 million. The fiscal year 2004 original budget presented on the budget and actual statements of the financial section of the CAFR includes adjustments (i.e. encumbrances, etc.) and therefore, will not calculate to the ratio increase of 6.9% for the fiscal year 2005 adopted budget mentioned above.

Several factors have impacted the revenue available for the fiscal year 2005 budget. This budget reflects a 9.7%, or $19.8 million, increase in the collection of real estate taxes over the fiscal year 2004 adopted budget with the tax rate remaining constant at $1.07 per $100. This budget assumes that the Commonwealth will continue to reimburse the County at the 70% rate for PPTRA. Beginning in tax year 2006, as a result of legislation passed during the 2004 General Assembly session to reduce a projected Commonwealth budget deficit, the Commonwealth will no longer reimburse localities at the current rate of 70%. Rather, the Commonwealth will cap statewide reimbursements at $950 million with each locality receiving a percentage based on tax year 2005 reimbursements. At this time, it is not known how the County will handle the change in Commonwealth funding for the PPTRA program. The fiscal year 2005 budget assumes an increase of 4.5% in local sales tax collection. Beginning in fiscal year 2005, an amount equivalent to 1.25% of sales statewide will be distributed among Virginia localities based upon the number of school age children residing within each locality. In past recent budgets, only 1.00% was distributed to localities. The increase of the Commonwealth sales tax to 4.00% enabled the Commonwealth to allocate the additional 0.25% to public school systems to meet unfunded needs. The fiscal year 2005 budget includes an increase in the residential inspection fee from $40 to $48. An increase in Waste and Resource Recovery fees and the elimination of the leaf vacuum service are also included in the fiscal year 2005 budget.

Difficult choices have been made as the Biennial Financial Plan for fiscal year 2005 and fiscal year 2006 were developed, and it represents a balance between available resources and needs. This balance was achieved using the objectives and priorities established by the Board of Supervisors and it is consistent with established countywide strategic goals.

CONTACTING THE COUNTY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the County's finances and to demonstrate the County's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Chesterfield County Accounting Department, 9901 Lori Road, Chesterfield, Virginia 23832.